

DHHS' Oversight of Its Rehabilitation and Development Programs Need Improvement

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Acronyms

CAPDA	Central Area Public Development Authority
DCD	Department of Community Development
DCLU	Department of Construction and Land Use
DHHS	Department of Housing and Human Services
ECR	Emergency Code Repair
HUD	U.S. Housing and Urban Development
NHRP	Neighborhood Housing Rehabilitation Program
PDA	Public Development Authority
SFMS	Seattle Financial Management System
SHA	Seattle Housing Authority

Purpose

In 1992, the City's three housing loan rehabilitation programs provided assistance to 184 homeowners with loans totaling \$1.8 million. The Department of Housing and Human Services (DHHS), the Seattle Housing Authority's Neighborhood Housing Rehabilitation Program (SHA/NHRP), and the Central Area Public Development Authority (CAPDA) administered these three programs. DHHS also provided loans totaling \$7.7 million to nonprofit agencies to produce 227 rental units in 14 multifamily projects.

The purpose of this review was to assess DHHS' management of housing rehabilitation and development programs and make recommendations for improvement. Specifically, we looked at:

- DHHS' oversight and implementation of its Single Family Rehabilitation Programs including the Emergency Code Repair (ECR) program;
- DHHS' management oversight of the Central Area Public Development Authority's (CAPDA) housing rehabilitation loan program;
- DHHS' management controls over the processing, recording, and reporting of expenditures for the Seattle Housing Levy; and
- DHHS' management controls over the Yesler Atlantic Land Sales and the Sixteenth Avenue Townhomes.

Background

DHHS' housing services encompasses a range of activities related to the following: helping people obtain housing; helping people keep housing where supportive services may enable them to live independently; providing services that prevent eviction or loss of housing; and providing services to people who are homeless. According to DHHS, their mission is to strengthen the ability of all people in the Seattle metropolitan area to live, learn, work and participate in safe, strong, and caring communities. The City will strive to maintain Seattle's ability to develop a range of low-income housing opportunities through supporting appropriate housing and community development agencies and by maintaining City capacity to leverage and administer local, state, and federal housing funds.

DHHS administers and oversees several different housing programs including single family home rehabilitation programs, multiple family housing rehabilitation and new construction development, and the City's Urban Renewal land sale.

Single Family Rehabilitation Programs

The City had three housing rehabilitation loan programs available to assist low to moderate income homeowners in 1992. DHHS administered the Emergency Code Repair Program (ECR)

and functioned as contract monitor for two other loan programs administered by CAPDA and SHA/NHRP.

These programs provide financial assistance to eligible homeowners in need of home repairs, ranging from \$500 to \$35,000. ECR and CAPDA provide both deferred-payment and amortized loans¹ at no or low interest rates, depending upon the homeowner's need, income, and level of debt. ECR's focus is to assist qualified low-income homeowners to correct hazardous conditions of an emergency nature in their homes by providing technical assistance and loans to accomplish required repairs. In 1992, these loans were generally small, averaging around \$5,000 to help the homeowner through the emergency situation. CAPDA provides home loans to address extensive rehabilitation needs to homeowners in the Central Area. In 1992, CAPDA's average loan was \$21,000. The SHA/NHRP program provides only amortized rehabilitation loans to low to moderate income homeowners. Thus, to qualify for an SHA/NHRP loan, a person must have enough disposable income to make monthly loan payments. According to an SHA/NHRP official, this is virtually impossible for many low-income homeowners, especially the elderly living on fixed monthly incomes. In contrast, the City receives repayments for deferred loans when the home is sold or upon the death of the homeowner. As a result, financial assistance is more accessible to very low-income homeowners through ECR and CAPDA programs than through SHA/NHRP. (See addendum A for a comparison of the three 1992 rehabilitation programs' characteristics and requirements.)

As of July 30, 1993, the City discontinued funding CAPDA's home rehabilitation loan program. CAPDA's rehabilitation program funds were transferred to DHHS' ECR program for administration. DHHS is completing home rehabilitation loans that CAPDA started and will continue to use CAPDA's funds to serve homeowners in the Central Area. In addition, during September 1993, City Council decided to consolidate SHA/NHRP into DHHS.

Seattle Housing Levy

DHHS is also responsible for administering three housing development programs of the Seattle Housing Levy Program. Voters approved the creation of the \$50 million Seattle Housing Levy Program in September 1986. This is an eight year levy designed to produce and preserve 1,000 housing units. The City uses the Levy funds to develop permanent, high quality housing that is affordable to very low-income families with children, individuals, and homeless adults with special needs. The Levy consists of four capital programs and an operating and maintenance trust fund. The Housing Levy program funds are available for both nonprofit and for profit sponsors for the acquisition, rehabilitation, and new construction of affordable housing throughout the city. The levy requires that 85 percent of the housing units produced by the levy be under the ownership and management of public or private nonprofit agencies. To date the housing levy program has produced 976 low-income units, or about 98 percent of the total production goal, using 75 percent of total levy production funds.

¹DHHS offers either deferred-payment or amortized loans to low income homeowners. The homeowner is not required to make loan payments on a deferred-payment loan. DHHS receives payment for these loans when the house is sold or upon the death of the homeowner.

Yesler-Atlantic Urban Renewal Plan

Presently, DHHS and the Department of Neighborhoods jointly oversee the Yesler-Atlantic Urban Renewal program². DHHS is responsible for the oversight of the residential properties and the Department of Neighborhoods is responsible for commercial properties. The mission and goals of the City's Yesler-Atlantic Urban Renewal Plan are to encourage rehabilitation, and development of quality and affordable housing to all moderate-income residents who might otherwise remain renters in Seattle's Central Area. The plan's goals include: community participation in the land disposition process; minority and local business participation in construction; and maximum use of both private and public resources to reduce the cost of new housing in the Yesler-Atlantic area.

In early 1970, the City acquired 43 acres of land with the intent to encourage rehabilitation, and development of quality and affordable housing to all moderate-income residents who might otherwise remain renters in Seattle's Central Area. Since 1976, the City has completed 31 Urban Renewal housing projects. In addition, several commercial, human services (parks and school) projects were completed on the urban renewal land. To date, only twelve parcels remain which include five residential and seven commercial parcels.

Sixteenth Avenue Townhomes

During the early 1980's, the City of Seattle, in conjunction with Shoreline Savings, financed CAPDA's development of the Sixteenth Avenue Townhomes. This project cost approximately \$1.3 million to build of which the City contributed about \$500,000 from Community Development Block Grant funds to cover construction costs, and another \$180,000 for CAPDA to purchase two parcels of land from the City's Yesler-Atlantic Urban Renewal Land. The City secured the loans with a deed of trust until CAPDA completed the project. To help low income home buyers afford the Townhomes, the City converted CAPDA's construction loan to individual amortized loans.

Scope and Methodology

The scope of our audit is to assess DHHS' management controls and practices over the City's ECR program, the Seattle Housing Levy programs administered by DHHS, the Yesler-Atlantic Land Sales and the Development of CAPDA's Sixteenth Avenue Townhomes. We also reviewed DHHS' management oversight of CAPDA's home rehabilitation loan program. We did not conduct a review of the SHA/NHRP program although we are providing limited information on the program to allow a full understanding of the City's overall single family rehabilitation programs.

We conducted our field work for the Seattle Housing Levy between March and May of 1993 and the remaining work between July 1993 and October 1993. During that time we:

²Previous to 1991, the Department of Community Development (DCD) was responsible for the program.

- interviewed DHHS management and staff, including staff who previously worked for CAPDA. We also met with CAPDA officials before the City discontinued funding its repair loan program and SHA/NHRP officials.
- reviewed DHHS' policies and procedures and other pertinent documents and reports relating to each of the programs.
- reviewed files including loan documents and progress payments.

We selected and reviewed 16 housing rehabilitation loan files, 12 from ECR and 4 from CAPDA, to obtain information on the factors involved in administering these programs. We selected the 12 loans from 120 loans issued by ECR in 1992. These loans were composed of both deferred-payment and amortized loans. The loans ranged between \$2,000 and \$15,000. We also selected and reviewed three out of the six CAPDA files that were in-progress and one out of eight CAPDA files that DHHS reopened due to warranty work in August 1993. All of CAPDA's loans that we reviewed were deferred-payment loans. These loans ranged between \$23,500 and \$35,650.

To assess the adequacy of DHHS' Seattle Housing Levy program, we judgmentally selected three out of the 44 projects, one each from the Downtown Preservation Program, Small Family Program, and Special Needs or Single Occupancy Housing Program. These three programs represent \$4.3 million or 20 percent of the total housing levy funds. We reviewed all 44 payment requests for these three projects to determine if expenditures were appropriately authorized.

In addition, we reviewed land sales in connection with two separate projects to see if the sales were in compliance with the Yesler-Atlantic Land Disposition policies and procedures. The first project that we selected, parcel 28 was sold on June 23, 1992 to build a triplex house. We selected this parcel since it was the most recently sold parcel. Since the City sold parcel 28 to a private developer, we evaluated the land sale based on the land disposition procedures for Sale at Public Bid. The second project that we reviewed transferred two parcels (3 and 4) to CAPDA to build the Sixteenth Avenue Townhomes in 1983. We based our compliance testing on the land disposition procedures for transfer to public corporations and the Critical Time Path Benchmark procedures that were in place during the sale of the parcels.

We also reviewed Department of Community Development's (DCD)³ management controls and its policies and procedures over the Sixteenth Avenue Townhomes project. The audit methodology consisted of interviews with DHHS management and staff, and a limited review of available DCD and CAPDA documentation dating back to 1983 when the project began. We were unable to conduct a full review because many of the records were unavailable.

³In 1991, the Department of Community Development was dissolved and the housing rehabilitation and development programs were transferred to DHHS.

Principal Facts and Findings

In our review of the current programs: the housing rehabilitation loan programs, the Seattle Housing Levy program and the Yesler Atlantic Land Sales, overall DHHS provides dedication to their management and internal controls to successfully carry out the programs. This is apparent through their immediate corrective actions to our findings and recommendations. The following principal facts and findings are the results of our review of the programs.

DHHS' management controls over its housing rehabilitation loan programs should be strengthened which would increase accomplishment of the programs' missions and would increase compliance with City policies and procedures.

For the housing rehabilitation loan programs, we found that the programs serve the low income and the very-low income population. However, we found that \$141,000 of CAPDA's funds and \$565,000 of SHA/NHRP funds in 1992 were unspent even though there was unmet need evidenced by a substantial backlog.

Our review of the ECR program showed that DHHS policies and procedures were revised periodically but were confusing during to the lack of dates and approvals. Also, we found that DHHS did not follow its policies and procedures or U.S. Housing and Urban Development (HUD) guidelines in several cases. Specifically, we found that within the twelve ECR case studies two homeowners received loans although they were not eligible to participate in the program; the guidelines designating the type of loan are insufficient and for two of the cases the interest rates were not consistent with policies and procedures; two loans were not secured by assets; DHHS' existing computer tracking system is not adequate to track the status of their ECR loan portfolio; DHHS does not conduct periodic reviews of loans to ensure that assets are safeguarded and to determine if a borrower can afford to make larger payments; and DHHS lacks documentation of management review to ensure proper review over one person who has responsibility for overlapping duties.

We found that the structural relationship between the City and the Public Development Authority (PDA) is appropriate if there are no major problems at the PDA level. However, if there are program or management control weaknesses at the PDA then DHHS needs to provide an increased oversight role for this structural relationship to be successful. During our review of DHHS' management oversight of CAPDA, we found that DHHS needs to strengthen its oversight in three areas. These areas relate to monitoring the segregation of duties at the PDA, DHHS' controls over contract payments such as periodic inspections, and properly updated program guidelines.

Overall, in our review of the Seattle Housing Levy management controls, we found minor weaknesses. There are three areas in which DHHS management controls should be stronger: reporting and monitoring of loans receivable, authorization of expenditures, and budgetary controls.

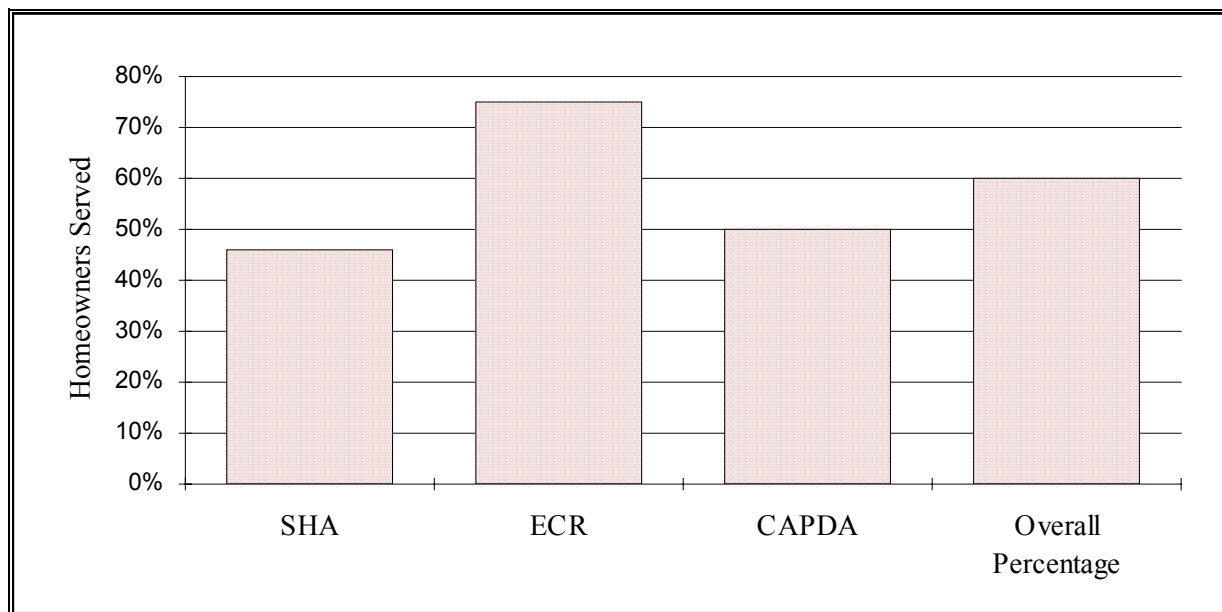
During our review we also found that Yesler Atlantic Land Sales was conducted in accordance with policy and procedures and provided an adequate level of management controls. For the Sixteenth Avenue Townhomes Development, we identified three problems that occurred at DCD: lack of effective working relationship with the Department of Construction and Land Use (DCLU), single family staff were not cross trained in multifamily construction, and there was a lack of project management policies and procedures. Since the Sixteenth Avenue Townhomes project these problems areas have been corrected and DHHS has developed a closer relationship with DCLU and will discuss potential problems up front; they have cross trained staff, and in 1987 they wrote a project managers handbook which strengthened their policies and procedures.

Demographics and Program Characteristics: Funds Should Be Fully Distributed

The need for low income housing repair funds are larger than the amount of funds available to complete all of the repairs. With the large backlog of applicants searching for funds to repair their homes, it is critical that the rehabilitation programs serve those for whom the City designed the program and that all funds are fully distributed. Even though the demand for the programs far exceed the program's capacity, in 1992, CAPDA and SHA did not expend over \$700,000, almost 29 percent of total available resources.

During 1992, the three rehabilitation programs served 184 households making over \$1.8 million worth of repairs. Fifty percent of the recipients were elderly and 60 percent were at or below 50 percent of the Seattle area median income. Table 1 shows the percentage of moderate income and low income homeowners served by each program.

Table 1: Percentage of Low Income Served for 1992



Each of the three programs serves different populations as shown in Table 2. ECR provided home rehabilitation to 75 percent of their recipients who are at or below 50 percent of the

median income while SHA and CAPDA provided 46 and 50 percent of their loans to this group, respectively. On the other hand, CAPDA provides 83 percent of its loans to minorities and/or single parents. See addendum B for specific percentages of those served by the rehabilitation programs.

Table 2: Characteristics of Those Served for 1992

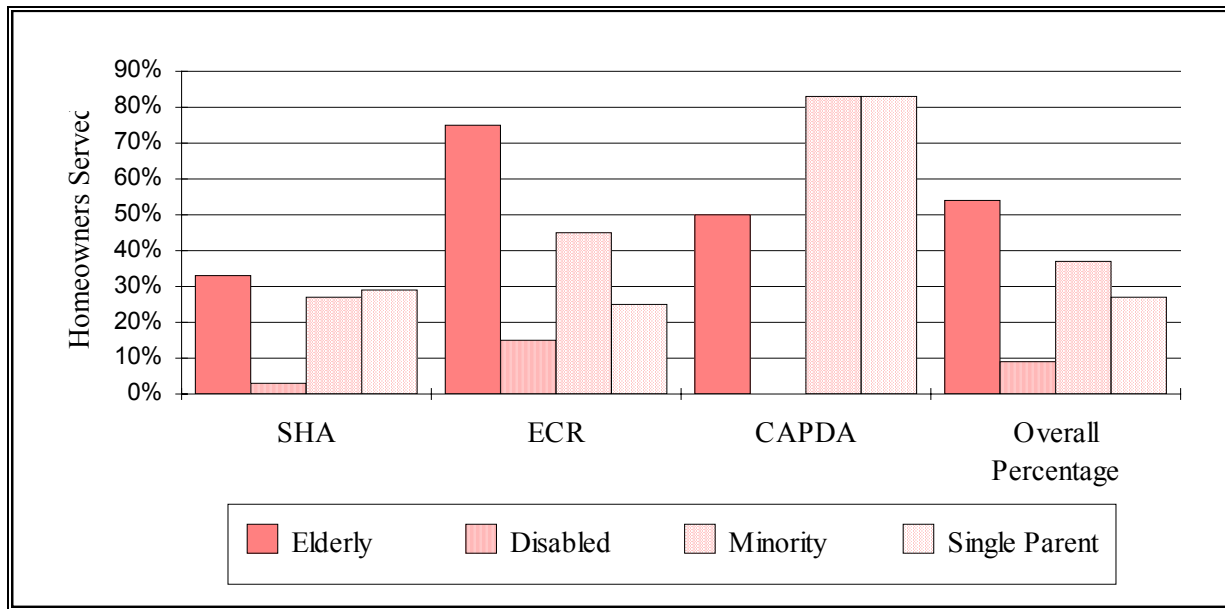


Table 3 provides financial data on the rehabilitation program for 1992. In total, the three rehabilitation programs had \$2,457,167 available for loans. However, the three programs only expended \$1,751,362. Almost 29 percent of program funds were not expended.

Table 3: Financial Data on Rehabilitation Programs for 1992

	<u>SHA</u>	<u>ECR</u>	<u>CAPDA</u>	<u>Total</u>
Total Loan Funds Available	\$1,540,217	\$650,000	\$266,950	\$2,457,167
Total Encumbered Loan Funds	<u>975,580</u>	<u>650,000</u>	<u>125,782</u>	<u>1,751,362</u>
Total Loan Funds Not Encumbered	<u>\$ 564,637</u>	<u>\$ 0</u>	<u>\$141,168</u>	<u>\$ 705,805</u>

Conclusion

The City's rehabilitation programs are serving Seattle's low and moderate income families. However, in 1992, CAPDA and SHA did not expend over \$700,000, almost 29 percent of total available resources, even though the demand for the program's far exceed the program's capacity.

Recommendation

- A1. Since consolidation of the three rehabilitation programs is now underway, DHHS should determine reasons for under expenditures and review its allocation of program funds among the City's rehabilitation programs. DHHS should ensure that all resources are expended to serve more citizens in need of housing rehabilitation assistance.

Emergency Code Repair Program Management Controls Needs Strengthening

DHHS has specific policies and procedures to administer the rehabilitation program. These policies and procedures are revised periodically. We found there is confusion as to which policies and procedures are in effect because they do not have an effective date and do not indicate when they were approved by DHHS officials. In addition, in the cases below, DHHS did not adhere to their policies and procedures. We reviewed 12 loan files involving approximately \$105,000 and found that not all loans serve those for whom the program was set up to serve and that DHHS is not adequately safeguarding their loans. We found out of the twelve case we reviewed, DHHS:

- provided two ineligible homeowners with loans;
- guidelines were insufficient to determine who should receive amortized and deferred-payment loans and for two loans DHHS did not properly apply criteria concerning what interest rate DHHS should charge the homeowner;
- did not ensure that two loan documents secured the City's assets;
- does not have an adequate system in place to track the repayment of loans;
- did not conduct periodic reviews of its loan portfolio to ensure that the City's loans are secured and did not determine whether, due to changed financial circumstances, a borrower can afford to make a loan payment or a larger payment; and
- did not document review of staff who have conflicting duties.

DHHS Control Over Revision and Adoption of Policies and Procedures Needs Improvement

We found in our review that DHHS revised their policies between 1992 and 1993 regarding the ECR program to reflect homeowners' and citizens' complaints as well as changes in median income guidelines provided by HUD. The revised policies and procedures showed no effective dates and evidence of approval by DHHS Officials. This has added significance due to the confusion caused by HUD's fiscal year for Seattle area median income, which is from December 1, 1991 through November 30, 1992. During our audit we received two copies of ECR's policies and procedures for 1992 that were different. We were unable to confirm the period for which the

policies and procedures were effective because they do not reflect the period for which they are effective and when they were approved.

Ineligible Homeowners Received Rehabilitation Loans

We found DHHS allowed two out of twelve ineligible homeowners to participate in their rehabilitation loan program. DHHS and HUD have specific criteria that an applicant must meet in order to participate in the rehabilitation programs. DHHS allowed two homeowners who did not meet these qualifications to receive low or no interest deferred loans. Both DHHS and HUD guidelines require that all applicants have income at or below 80 percent of Seattle area median income. ECR's policies stated that they will decline applicants if:

- they are past due on their real estate taxes;
- their loan-to-value ratio currently exceeds 100 percent;
- they have 3 or more existing liens on their property;
- they do not have clear title or have a real estate contract with a balloon payment due in less than three years;
- they are in bankruptcy; or
- they are above the allowable asset levels⁴.

We found that two of the twelve recipients we reviewed whose loans totaled \$26,796 were not eligible to participate in the loan program. One recipients was ineligible because she did not meet both DHHS and HUD requirements. Her household income exceeded the prescribed limit. One recipient was not eligible because she also had more than the allowable number of liens already placed on her residence. In addition, for three other recipients, we were unable to confirm if DHHS verified income data such as, social security, alimony or rental income. According to DHHS officials, they routinely request copies of most recent income tax returns if needed to verify income.

We also found that the approval of loan applications were not documented in the files. ECR policies and procedures require that loans exceeding \$10,000 but less than \$15,000 be approved by the Unit Manager. All projects that are estimated to exceed \$10,000 will be presented at loan committee for approval prior to bidding. Loans not exceeding \$10,000 should be approved by the Senior Finance Specialist. For eight of the twelve loans, we did not find any evidence of approval in the loan file.

Inconsistent Determination of the Terms of the Loan and Security of Loans

⁴The allowable assets for elderly (over 65) and handicapped households must not exceed \$50,000. The allowable assets for non-elderly households must not exceed \$25,000.

DHHS does not have general guidelines to consistently determine who should receive amortized or deferred-payment loans and does not consistently apply interest rates the borrower should pay. In addition, two out of twelve cases did not ensure that all pertinent loan documents were properly executed and therefore, increases the City's risk of losing the collateral that secures the loans. DHHS determines whether a homeowner can afford to make monthly payments based on the owner's "usable" income, defined as income after the owner pays all other usual monthly expenses. If the owner cannot afford monthly payments, the owner receives a deferred-payment loan that is paid at the sale of the property, death, or after 20 years, whichever comes first. DHHS required some homeowners with considerably less usable income to make the same monthly payments as homeowners with considerably more usable income.

In 1992, DHHS' policies and procedures state that the interest rate for all loans will be set at 3 percent unless (1) the borrower's income is at or below 50 percent of the Seattle area median income and the owner is making monthly payments, then the loan will carry a zero interest rate; and (2) if the owner(s) have excessive medical expenses and the cost of medical expenses puts the owner(s) below 50 percent of the median income, DHHS can wave the interest rate.⁵ We found that two out of the twelve loans, DHHS did not assign the interest rate stated in the policies. Both borrowers received zero percent interest rates when they should have received 3 percent loans. One borrower's income was above 50 percent of the Seattle area median income and another elderly borrower should have received a 3 percent interest rate since he had a deferred loan.

The City could lose repayment of loans if DHHS does not properly execute all pertinent and necessary documents to secure City assets. In two of the twelve cases we reviewed, DHHS did not properly execute legal documents to secure City assets. In one case, the loan amount for the promissory note did not agree with the amount on the final disclosure statement signed by the borrower. In the other case, the City's lien on the property was in fifth position rather than within the first three lien positions, as required by DHHS' policies and procedures. DHHS officials stated that they are correcting the problem and are revising their internal procedures to ensure these problems do not reoccur.

Repayment of Loan Portfolio

ECR recycles its loan funds through the program, using the amounts received from the repayment of the loans to generate new loans. The lack of an effective loan tracking system deprives management complete and accurate information to effectively manage and monitor the ECR loan program. The current loan tracking system does not provide sufficient information to monitor receivable and track loan due dates. Although we requested typical loan repayment data from DHHS, DHHS' system could only provide some overall portfolio information. As of October 1993, ECR's total loan portfolio was \$3.4 million consisting of about 840 loans. During

⁵In 1993, DHHS changed its interest rates to zero percent or 2 percent depending on age, income and whether or not the borrower is handicapped. All loans to seniors (65 or older) or handicapped homeowners whose annual income is at 50 percent or below the Seattle area median income shall receive a zero percent interest loan. All other loans shall be at 2 percent interest.

1992, the City received \$523,000 in principal and \$8,100 in interest. Due to inadequate loan tracking, DHHS officials are unsure of the accuracy of these numbers.

DHHS' computer system could not provide the following information:

- the percentage of the total loan portfolio that are deferred loans and the number and dollar amount of these loans;
- the percentage of the total loan portfolio that are amortized loans and the number and dollar amount of these loans;
- the number of deferred loans that were paid off during 1992;
- the number and amount of payments on amortized loans per year; and
- an aging of the loan portfolio and individual loans.

This problem has increased significance as DHHS adds CAPDA's and SHA's loans to its portfolio. DHHS officials are aware of the problems with their loan tracking system and are currently reviewing their options to improve their loan tracking system.

Periodic Review is Needed to Ensure City's Interest and to Determine if Borrower Can Afford to Make Larger Payments

DHHS currently does not conduct periodic reviews of its loan portfolio to ensure that the City's interest in the home is secured nor do they determine whether or not a borrower can afford to make larger loan payments. It is important for DHHS to conduct a periodic review of its loan portfolio to identify loans that are in serious default, to determine if the City is at risk of losing its security interest in the property, and to determine whether a borrower's financial status has improved to enable him or her to make larger loan payments. It is important for DHHS to conduct periodic reviews of its loan portfolio, especially since as of October 1993, 16 percent or \$535,000 of ECR's total loan portfolio are deferred-payment loans and the City will not receive a return on its investment until the property is sold or the owner dies. DHHS has not received a payment since February 28, 1993, for at least 21 of the 88 amortized loans made in 1992.

DHHS does not review and update household income of borrowers to determine if an accelerated payment schedule is appropriate. Borrowers are required to make monthly payments based on the amount of their usable income (income after usual monthly expenses). Without a periodic review, DHHS would not know whether a borrower could afford to make an increased payment.

Segregation of Duties

Our review of the control structure disclosed that the Construction Specialists perform a number of duties that have conflicting interests. One person has the responsibility for determining the scope of work, selecting the contractor, conducting inspections and approving contractor's invoices. However, ECR policies and procedures state that the Senior Construction Specialist

reviews and approves the scope of work, selection of the contractor, reviews the inspection reports, and approves the contractor's invoices. Although we did not find evidence of review of all of these items, if the supervisor is providing the review function as stated, the conflict of interest is minimized.

Conclusion

DHHS can strengthen its management controls by more effectively promulgating policies and procedures; ensuring that only eligible homeowners receive rehabilitation loans; determining loan terms in accordance with policies and procedures; securing assets by properly filing all appropriate loan documents; conducting a periodic review borrowers to ensure assets are safeguarded and determining if the borrower can afford to increase their monthly payment and making a decision of what type of loan tracking system it will use to manage and monitor the consolidated loan program.

Recommendations

We realize that the rehabilitation program was designed to provide low to moderate income homeowners with affordable rehabilitation loans. We anticipate that only one of our recommendations (B4) has an additional cost that DHHS with input from City Council should consider the net cost and benefit of monitoring the loan portfolio through periodic reviews versus providing grants to specific targeted groups.

We recommend the following actions for DHHS to strengthen its oversight and management controls over the ECR program:

- B1. **Revision and adoption of ECR's policies and procedures.** We recommend that DHHS officials ensure that ECR's policies and procedures reflect their effective date and approval by senior management.
- B2. **Ensure program requirements are met.** To ensure that DHHS is meeting all program requirements, we recommend that the controls include a form including a checklist for determining eligibility, loan approval, and securing the City's asset. A copy of the checklist should be filed in each loan file. The checklist should include sufficient detail to demonstrate that the homeowner and or DHHS has completed the following items:
 - the borrower is eligible to participate in the program and meets the specific criteria;
 - the borrower is eligible for a deferred or an amortized loan and the interest rate that is applicable; and
 - the loan is properly secured (e.g., DHHS receives a Deed of Trust and a Promissory Note for the amount borrowed, and a lien is placed on the property).

Although, DHHS stated that they request certain applicants for copies of their most recent income tax returns if needed to verify income, we recommend that they should consistently

request it from all applicants to confirm income and to also identify other income and assets that are not included on the application.

- B3. **Loan Tracking System.** DHHS should continue to review its loan tracking options. DHHS should consider the pros and cons of keeping its loan tracking system within DHHS or contracting with an outside source. In their analysis DHHS should review a loan tracking system similar to the way the Office of Economic Development has contracted out their Small Business Loan Program. If DHHS contracts this service out, it should follow the City's contract guidelines which may require a competitive bid process.
- B4. **Periodic Review of Borrowers.** DHHS management should consider conducting a periodic review of household income and assets to determine status and whether loan payments should be changed. With input from Council, DHHS should determine if it is cost beneficial.
- B5. **Improve the segregation of duties and overall administration of the process.** DHHS management should ensure that major responsibilities and duties that are not adequately segregated should have documentation of review.
- B6. **Loan Approval Should be Documented** The approval decision of all loans should be appropriately documented with a signature and date of the approving official.

DHHS' Corrective Measures

DHHS has started to address our audit recommendations. For some recommendations, they have already implemented corrective actions while other recommendations they are starting to work on. DHHS provided us with the following list of actions that DHHS has or is taking to correct the problems:

- 1. **Policies and Procedures** -- DHHS is in the process of creating new policies and procedural guidelines for the 1994 consolidated program. DHHS will review a number of policy questions with City Council as part of the consolidation review.
- 2. **Ensure program requirements are met.** To ensure that DHHS is meeting all program requirements, a checklist has been developed to ensure the three points mentioned in the audit are completed for each loan. DHHS also uses checklists for other items now, as well. DHHS started using the checklist December 6, 1993.
- 3. **Loan Tracking System** -- DHHS recognized earlier this year that they needed a better, more reliable loan tracking system. They are doing two things at this time to develop such as system:
 - a. Single family rehabilitation program consolidation planning now under way is including an investigation of the following loan tracking system options:
 - DHHS creates tracking system function within the department;

- DHHS contracts with SHA to provide tracking services; SHA has a loan servicing system currently in place for NHRP program loans;
- DHHS contracts with a private agency to track loans. DHHS is consulting with Office of Economic Development staff on this option.

DHHS will be looking at staffing and cost implications of each options; results of their investigation and their preferred option will be reviewed with City Council as part of their consolidation efforts.

- b. While DHHS is working on #1 above, they will update the status of DHHS' single family loan portfolio. Information on current status is being brought current in order to move it into their new tracking system during first quarter, 1994.
4. **Periodic Review** -- DHHS plans to incorporate a periodic review of loan status into their loan tracking system. DHHS is considering whether it makes sense to review loans for possible change in loan repayment schedules. DHHS is assessing the administrative cost of doing so versus what they are likely to gain from such a procedure given that their borrowers are low-income homeowners. If DHHS decides to keep that program feature in 1994, they will develop more detailed procedures for ensuring review occurs in conformance with program policy.
5. DHHS will be using a loan committee structure to review single family rehabilitation program loans under their consolidation plan. DHHS acknowledges that their present ECR program "loan committee" functions more as a staff meeting than a formal body. DHHS intends to include non-DHHS persons on the new Committee as well as appropriate DHHS staff. Membership and function of the Loan Committee will be clearly described in new loan policies and procedures now under development for their 1994 consolidation program.

DHHS' Oversight Needs Strengthening, If CAPDA Is Replaced

We found that the structural relationship between the City and the PDA is appropriate if there are no major problems at the PDA level. However, if there are program or management control weaknesses at the PDA then DHHS needs to provide an increased oversight role for this structural relationship to be successful. During our review of DHHS' management oversight of CAPDA, we found that DHHS needs to strengthen its oversight in three areas to ensure that homeowners living in the Central Area receive adequate housing services. The three areas relate to segregation of duties, controls over contract payments, and program guidelines. With adequate management controls, clear and reasonable performance standards, sufficient funding, and a good working relationship with DHHS, a nonprofit organization should be able to successfully meet the City's housing goals and objectives for the Central Area.

PDA and Nonprofits Should Have Appropriate Segregation of Duties

Presuming DHHS takes on an increased oversight role when PDAs have programmatic or management problems, DHHS should monitor and report inappropriate segregation of duties and inadequate internal controls at the PDA or nonprofit. DHHS should consider enforcement by threatening to discontinue funding.

We found key duties and responsibilities within CAPDA's rehabilitation loan program were not appropriately segregated among CAPDA's employees. DHHS requires CAPDA to maintain an effective system of internal control to ensure that funds are used solely for authorized purposes. However, CAPDA's ability to appropriately segregate key responsibilities and duties was limited by the number of program staff and high staff turnover, according to DHHS and CAPDA officials. CAPDA's Executive Director stated that he only had two people working on the rehabilitation program and, thus, realized that the program was vulnerable to fraud. As a result of inadequate segregation of key duties and responsibilities among staff, CAPDA lacks the checks and balances needed to reduce the risk of fraud and mismanagement of funds occurring and going undetected, which could cost the City a significant amount of money.

CAPDA's Construction Representative controlled major aspects of CAPDA's rehabilitation program. CAPDA's Construction Representative was responsible for inspecting homes, determining repairs needed and cost estimates; preparing work specifications (e.g., the scope-of-work); conducting a competitive bid process; assisting homeowners in selecting a contractor; monitoring and inspecting construction work; verifying contractors' invoices requesting payment to the actual work completed; preparing and approving payment requests; obtaining the homeowner's signature authorizing a payment request; and submitting payment requests for processing to DHHS. The State Auditor's Office conducted a special audit of CAPDA and reported in December 1993 that because too much responsibility was vested in CAPDA's Construction Representative, combined with inadequate supervision of his work, CAPDA's Construction Representative authorized an overpayment of at least \$18,600 to one contractor in 1992. This overpayment was not detected until a former CAPDA employee reported her concern of CAPDA's mismanagement of funds to the State Auditor's Office on December 12, 1992. To conceal the fraudulent payment transactions, CAPDA's Construction Representative falsified payment requests on behalf of two homeowners, according to the State Auditor's.

DHHS had knowledge of problematic internal controls at CAPDA through a management letter, findings and recommendations from the State Auditor's Office's previous audits. Also DHHS received complaints from homeowners.

DHHS Should Have Proper Control Over Contract Payments

We found that DHHS' oversight of CAPDA was not adequate to ensure that contractors are only paid for actual work completed. Also, DHHS' policy of only conducting final inspections of CAPDA's rehabilitation work may not be adequate. Program guidelines state the City shall not issue contract payments in excess of actual construction completed. To ensure that contract payments are not issued in excess of actual work completed, construction should be inspected and verified when a contractor makes a request for payment.

Based on our review of four CAPDA files, we found instances where authorization procedures for payment requests were not followed. We found that DHHS approved and issued contract payments without an invoice specifying work completed for 8 of the 11 payments that we reviewed. We also found that DHHS approved and processed final contract payments, for all three of the loan files that were completed, without a copy of the work specifications initialed by the Construction Specialist and homeowner showing the date of completion for each line-item. For one file, DHHS approved and processed the final payment including the 10 percent retainage amount, although the inspection report prepared by DHHS construction staff identified incomplete work. Also, in 1993 there were eight CAPDA projects that needed warranty work, costing the City an additional \$52,000 in new contractor payments which DHHS officials do not expect to recover. Periodic inspections would identify poor quality work earlier and final inspections would reduce cost to the City for warranty work.

Similar to our findings, the State Auditor's Office report in 1993 found that DHHS did not comply with required procedures resulting in an overpayment of \$18,600 to one contractor. The contract overpayment occurred without all required signatures. This was because the finance unit supervisor who normally approves payment requests was on vacation and her replacement staff was not familiar with the authorization procedures for payment requests, according to DHHS officials.

DHHS' Finance Unit Supervisor should review all of CAPDA's progress payment requests for appropriate signatures and compliance with applicable policies and procedures. Prior to processing, DHHS' Finance Unit Supervisor should indicate approval of each payment request by signing the form. The City rehabilitation guidelines for CAPDA requires the signature of CAPDA's Construction Representative and homeowner on all payment requests. In addition, according to these guidelines, DHHS should receive the following documents before final payments are approved and processed:

- a payment request indicating rehabilitation work is 100 percent complete, signed by the homeowner and the construction specialist;
- appropriate lien releases from the contractor;
- verification that work under permit has been approved by DCLU and/or other appropriate City departments;
- a copy of the work specifications with each line-item initialed by the rehabilitation specialist and homeowner with date of completion noted; and
- an invoice from the contractor.

DHHS Should Update Program Guidelines Annually

During our review we found that some areas of the City's CAPDA Loan Program Guidelines were outdated and did not reflect current practices. Written policies and procedures are

important management controls because they help ensure consistency in operations, are a source of reference for employees, and act as a training guide for employees. By not updating policies and procedures annually, management is at risk of program noncompliance with policies and procedures, which could weaken controls in place to protect public funds.

We found that the City's CAPDA Loan Program Guidelines were revised on April 13, 1993, CAPDA was using HUD's 1991 Seattle median income limits to ensure that only eligible homeowners are served by the program. As a result of not updating policies and procedures to reflect current practices, DHHS and CAPDA are at risk and may incorrectly determine that a homeowner is eligible to receive rehabilitation services.

Conclusions

At the City and PDA structural level, we found no inherent problems with the relational organization structure and DHHS agreed. If the City decides to enter into a new contract with another organization to provide housing rehabilitation services in the Central Area, DHHS should provide increased oversight to help ensure that the program successfully meets the City's housing goals and objectives. DHHS should expand its oversight role over the Central area organization to ensure that key duties and responsibilities are adequately structured, segregated and performed. Also, DHHS should not only conduct final inspections, but using their judgment and knowledge of the specific projects periodically conduct inspections during construction to verify construction work completed. Furthermore, DHHS should update its policies and procedures annually to reflect current practices and to ensure program compliance with applicable laws and regulations.

Recommendations

When working with a private nonprofit, DHHS must establish in the contract clear and reasonable performance expectations. The main emphasis in City contracts should be on measurable outcomes. DHHS does require the PDA to have the minimum necessary management controls but they should also monitor and enforce this when they are aware of programmatic or management problems. To build successful working relationships with private nonprofit organizations, DHHS should:

- C1. Update Program Guidelines Annually.** DHHS should review program guidelines established for the housing rehabilitation loan programs annually and update and/or amend them as needed; and document in writing the policies and procedures for major aspects of each loan program to ensure that program operations are consistent and in compliance with applicable laws and regulations.
- C2. Improve Controls Over Contract Payments with Inspections.** DHHS should improve its controls over contract payments by conducting final inspections and using their judgment and knowledge of the specific projects, to periodically inspect contractor's work during construction to verify the percentage of work completed as stated on partial payment requests. We believe that periodic inspections will increase the chances of identifying fraudulent payment requests and, thereby reduce the risk of individuals authorizing and

processing contract overpayments in the future, for fear of being caught. Collusion, however, can reduce or destroy the effectiveness of conducting periodic inspections. Thus, we also recommend that no prior notice of inspections be given to further reduce the risk of collusion. If an organization, such as CAPDA, is aware that DHHS may conduct an inspection at any time, the risk of contract overpayments occurring and fraudulent activities going undetected will reduce. Periodic inspections may also decrease the extent of future warranty work, currently costing the City \$52,000 in 1993, by identifying poor quality work not detected by a nonprofit organization prior to processing final contract payments. DHHS should improve its control over contract payments by also requiring a qualified third person within an organization, such as the Executive Director of CAPDA, to review, approve, and sign all payment requests before they are sent to DHHS for processing.

- C3. **Ensure Only Qualified Staff Execute Work.** Currently, when DHHS' finance unit supervisor is absent from work, untrained staff handle the contract payment requests. DHHS should cross-train staff so that when absences occur due to illness or vacation, other staff are qualified to fill in.
- C4. **Monitor and Enforce PDAs to Have Management Controls.** DHHS should monitor and consider enforcing PDAs' requirement to have at least minimal controls with the threat of discontinuing its funding. DHHS should use the PDA's annual audit report and management letter from the State Auditor as an indicator of problems and what DHHS' oversight role should include. Addendum C describes the fundamentals of management control systems. In regards to the problems DHHS experienced with CAPDA, DHHS will want to ensure that key duties and responsibilities are adequately structured and segregated among individuals within the new organization with proper review from the supervisor.

DHHS' Internal Controls Over the Seattle Housing Levy Program Need Strengthening

During our review of DHHS' internal controls over the Seattle Housing Levy Program, we identified three areas in which DHHS should strengthen their internal controls to ensure funds are being spent for the intended purpose and in compliance with applicable laws, rules and regulations. The three areas concern reporting and monitoring of loan receivable, authorization of expenditures, and budgetary controls.

Reporting and Monitoring of Loan Receivable

The current loan tracking system does not provide sufficient information to track loan due dates and monitor loans receivable. Housing Levy funds may be used for long-term deferred-payment loans which must be repaid upon sale, change of use, or at the end of the loan term. Borrowers may further defer payment of principal, deferred interest, and contingent interest by extending the loan term. In some cases, loan terms may be extended to 75 years. The current system does not identify loans based on their loan due dates and cannot produce the amount of loan receivable due for any given period. Currently, loans must be manually identified from a loan portfolio report of over 200 loans and total receivable calculated for each period. This condition

may allow loans due dates to be overlooked, loan remittances to be misappropriated, and delinquent loans to go unnoticed. Loan due dates need to be tracked in order to monitor loan receivable.

Authorization of Expenditures

DHHS is processing requests for payments without proper authorization. Unauthorized invoices or billings may be processed and levy funds expended for work not completed or authorized. We reviewed all of the 44 payment requests in three project files and found that six requests did not show proper authorization. These six requests lacked either the project manager's signature or the construction supervisor's signature. In addition, the Housing Division's Finance Section did not sign the request for funds indicating their review and approval. DHHS officials have indicated that they understand the need for proper authorization to ensure that levy funds are expended appropriately and said that future requests will have proper signatures.

Budgetary Controls

DHHS management is not reviewing SFMS reports (Account Summary by Project) on a regular basis. We reviewed three projects and found that project budgets are entered into SFMS two to three years after the budget has been approved and expenditures are not being recorded against the proper budget year. DHHS records and accounts for expenditures by funding source. The Josephinum project showed different project numbers for each of the three budget years. For this project, DHHS consolidated all expenditures under one project number causing a negative fund balance during that year. The Victorian Row project had five project budgets that totaled approximately \$1.3 million rather than the actual fund allocated amount of \$673,000 for three budget years. In the last case, William Booth/Salvation Army, the expenditures were posted for each budget year however, the budget amounts were not posted until two to three years after the budget was appropriated causing negative fund balances in two of the four project budgets. These negative fund balances were as much as \$950,000.

Conclusion

DHHS can improve its internal controls over the Seattle Housing Levy by collecting sufficient information to monitor and report on loan receivable; by ensuring that all processed payments are properly authorized; and by improving budgetary controls.

Recommendations

- D1. We recommend that loan receivable be tracked and monitored by loan due dates. One option, as discussed with Housing Division staff, is to expand the current loan portfolio report to include a column for the loan due date by which loans can be sorted and receivable monitored.
- D2. We recommend that invoices and billings be properly reviewed and authorized by the construction manager, construction supervisor, project manager, and finance team as

indicated in the Housing Division's written policies and procedures for the advancement of project funds.

D3. We recommend that DHHS:

- enter all project budgets into SFMS at the time the projects are approved;
- reconcile SFMS project budgets to the Administrative and Financial plan;
- close out project budgets at the end of each year and if the project is not complete, transfer any remaining balances to the next year's budget;
- review and monitor SFMS reports on a regular basis to ensure that expenditures are properly recorded and processed as authorized; and
- document management's review of the SFMS reports.

DHHS' Corrective Measures

DHHS officials agreed that a loan tracking system is needed for their multifamily program loans. The system options being developed for their consolidated single family program will incorporate their multifamily loan portfolio as well.

Development Program

We reviewed two development projects which were completed by DHHS and its predecessor, DCD. Our review found that one of the projects, the Yesler Atlantic Land Sales was conducted in accordance with policy and procedures and provided an adequate level of management controls. The second project, the Sixteenth Avenue Townhomes was hindered by weaknesses, including lack of inter-departmental communication between DCD and DCLU, lack of appropriately qualified staff, and weak procedures and measurement standards over problems that occur.

Yesler Atlantic Land Sales

DHHS is providing proper oversight of the Yesler-Atlantic land sale's residential properties. We reviewed the land sales for two separate residential projects. One parcel was for the development of a triplex housing unit to a private developer. This property was sold on June 23, 1992. In 1983, DCD sold two parcels to a public corporation, CAPDA to build the Sixteenth Avenue Townhomes. Both properties were sold in accordance with the procedures in place at that time.

Prior to 1984, the City utilized the land sale procedures laid out in the Critical Time Path Memorandum to sell residential properties. In May of 1985, City Council adopted the Yesler-Atlantic Land Disposition Report. Currently, DHHS and the Department of Neighborhoods are

requesting that these policies and procedures be amended to streamline the disposition process, to eliminate nonproductive steps, to provide a more clarified decision-making process prior to City Council action, and to include provisions for terminating developers for non-performance.

Sixteenth Avenue Townhomes

In 1983, CAPDA embarked on its first attempt at managing a project as the sole developer. The Sixteenth Avenue Townhomes Project consists of 23 townhomes designed to accommodate the housing needs for low and moderate income families. DCD served as the City's representative and oversight coordinator in this project.

Throughout the construction of the project, there were several problems that caused noticeable deficiencies in all 23 units, such as leaking roofs, breakage of stair treads, nonfunctional side sewer and generally poor craftsmanship in all units. DCD was aware of some of the problems prior to construction and some of the problems arose during construction.

DCD was aware and raised concerns about the lack of dimensioning and detailing of the drawings and specifications but let the project go to bid. Since DCLU is responsible for assuring that housing projects meet the Seattle Housing Code prior to issuing a permit, DCD believed that DCLU would identify the same problems and require the architect to correct the deficiencies prior to authorizing the building permit. However, DCLU approved the project and authorized the building permit. According to a DHHS official, the coordination has changed whereby DHHS and DCLU have a closer relationship that allows them to freely identify and communicate identified construction problems.

Other problems that arose during the course of construction that DCD did not have any control over included the surveyor who continued to survey the site even though his instrument was malfunctioning. In addition to the survey mistake, the preconstruction soils analyst failed to detect buried concrete foundation footings, and oil storage tank and substantial fill material that caused additional grading and fill problems. These two problems cost the City approximately \$10,000. Another problem was caused by the contractor's site supervisor who was not performing professionally and was generally doing unacceptable work. The architect stated that the site supervisor was not effective with managing subcontractors, lacked control over the job site, and did not properly schedule events. A DCD official stated that in hind sight, the department was not assertive and demanding enough to correct identified problems in a timely manner.

DCD assigned single family staff to oversee the Sixteenth Avenue Townhome project since it did not have enough qualified multiple family staff. Development staff lacked expertise in new construction of multiple family projects, including contract development and monitoring, and change order management. According to a DHHS manager, staff are now trained in both single and multiple family construction.

Conclusion

We did not find any internal control or management weaknesses in DCD's management of the Yesler Atlantic Land Sales. The Sixteenth Avenue Townhomes development, however, was marked by numerous problems which can be attributed to internal control and management weaknesses. Because of poor inter-department communication, DCD did not inform DCLU of problems DCD knew about. DCD staff lacked the qualifications to oversee the development of a multiple family project. Because DCD had weak procedures and measurement standards, a number of problems that should have been identified and corrected in a timely manner.

Recommendations

E1. We recommend that DHHS ensure any future development project have:

- clear and frequent communication with other relevant City Departments;
- appropriately qualified staff; and
- adequate procedures and measurement standards.

DHHS' Corrective Measures

DHHS noted the problems identified concerning the Sixteenth Avenue Townhomes project. DHHS is committed to following through with recommendations in our audit report. DHHS' multifamily project policies and procedures are much better developed now compared to ten years ago when the Sixteenth Avenue Townhomes were developed.

Comparison of the Three 1992 Rehabilitation Programs Requirements

	DHHS' ECR	CAPDA	SHA
Total Funds Available for Loans	\$650,000	\$266,950	\$1,540,217
Total Encumbered Funds	\$650,000	\$125,782	\$975,580
Total Unencumbered Funds	\$0	\$141,168	\$564,637
Number of Households Served	120	6	58
Average Loan	\$5,078	\$20,964	15,254
Eligibility Requirements			
• Income Limits	Less than 80% of Seattle area median income	Less than 80% of Seattle area median income.	Less than 80% of Seattle area median income
• Assets Limits	<ul style="list-style-type: none"> • Non-Elderly < \$25,000 • Elderly or Disabled < \$50,000 	Gross assets < \$15,000	<ul style="list-style-type: none"> • <\$40,000 in liquid assets • < \$150,000 in non liquid assets
• Owner Occupied	Yes	Yes	Yes
• Current on Tax Assessment	Yes	Yes	Less than 80%
• Loan to value	Up to 100% of value after rehabilitation and less prior or existing liens	Up to 95% of value after rehabilitation less prior or existing liens.	
• Title Insurance	Must have clear title.	Must have clear title	Must have clear title
• Lien position	Must be within first three lien positions	Must be within first three lien position.	
Loan Terms			
• Maximum Loan Amount	Average loan for 1993 is \$8,000. (90% can go up to \$15,000 and 10% can go up to \$30,000.)	Up to \$35,000 to comply with Seattle housing building and maintenance code.	<ul style="list-style-type: none"> • \$25,000 for loans from CDBG funds • No limit on private loans
• Interest Rate	All deferred loans 3% except those who are less than 50% median income and have amortized loans.	4%	3% to 8% depending on income and amount of loan
• Length of Loan	20 years maximum	10 years (can be extended 15 years for a total of 25 years)	20 years maximum
• Loan Payment	Based on disposable income		Borrowers must make monthly payment, based on income and amount of loan.
• Type of Loans	Amortized and Deferred	Amortized and Deferred	Amortized
Construction/Contractor			
• Selection of Contractor	Lowest bidder from qualified contractor's list or homeowners choice approved by DHHS.	Lowest bid or homeowners choice of contractor within 10% of CAPDA's cost estimate.	Homeowner selects contractor
• Progress Payment	<ul style="list-style-type: none"> • One payment for projects < \$7,500 • Partial draws for projects > \$7,500 	<ul style="list-style-type: none"> • Two payments (Normally one at 50% of completion and the other at 100% of completion) • Three payments for loans greater than \$8,000 	<ul style="list-style-type: none"> • Down Payment not to exceed 30% of contract amount • No more than three payments during construction.
• Retainage Fee	10%	10%	

Demographics of the Three Rehabilitation Programs for 1992

Program Characteristics	SHA	ECR	CAPDA	Total
Total funds for loans and/or direct service assistance	\$1,540,217	\$650,000	\$266,950	\$2,457,167
Total Number of Households Served	58	120	6	184
Moderate-income (at or below 80% median income)	100%	100%	100%	100%
Low-income (at or below 50% median income)	46%	75%	50%	60%
Elderly	33%	75%	50%	54%
Disabled	3%	15%	0%	9%
Minority	27%	45%	83%	37%
Single Parent	29%	25%	83%	27%
Location of Rehabilitation	City-wide	City-wide	Central Area	

Management Control Systems

The management control system is the fundamental system an organization uses to ensure

- that the organization obligates and spends its funds in compliance with applicable law,
- that assets, including staff time, are safeguarded against waste, loss, unauthorized use, and misappropriation, and
- that revenues and expenditures applicable to the organizations operations are recorded and accounted for properly.

Management control encompasses all activities designed to assure that an organization accomplishes its objectives effectively and efficiently (1) within the planned time frame, (2) within approved cost limitations and (3) with the planned quality and quantity of output.

The control process spans the whole gamut of management activities from deciding what the organization should do or what it should emphasize, to allocating funds, monitoring activities, conducting reviews, making mid-course corrections and evaluating organizational and individual performance. As such, it differs from internal accounting control because of its emphasis on results.

Good management controls are essential to achieving the proper conduct of Government business with full accountability for the resources made available. They also facilitate the achievement of management objectives by serving as checks and balances against undesired actions. In preventing negative consequences from occurring, management controls help achieve the positive aims of program managers.

Management Controls consist of the control objective(s), control procedures, the accounting system, and management's monitoring system.

Control objectives are the positive effects that management tries to attain or an adverse condition/negative effect that management is seeking to avoid.

Control procedures are the specific steps established by management to provide reasonable assurance that control objectives are achieved.

Accounting system includes the methods and the records used to identify, assemble, analyze, classify, record, and report transactions and maintain accountability for assets, liabilities, revenues, and expenses.

Monitoring system includes management's methods for following up and checking on performance to ensure compliance with control and accounting procedures. It includes internal auditing functions and systems for following-up on needed corrective actions.

Management control systems should be logical, reasonably complete and likely to deter or detect possible misuses, failure, or errors.

The general standards for assessing a management control system include:

- reasonable assurance,
- competent personnel,
- control objectives, and
- control techniques.

Management control systems are to provide reasonable assurance that the objectives of the systems will be accomplished. Managers and employees are to have personal and professional integrity and are to maintain a level of competence that allows them to accomplish their assigned duties, as well as understand the importance of developing and implementing good internal controls. Management control objectives are to be identified or developed for each agency activity and are to be logical, applicable, and reasonably complete. Management control techniques are to be effective and efficient in accomplishing their control objectives.

More specifically, the standards for a quality management control system concern documentation, recording of transactions and events, execution of transactions and events, separation of duties, supervision, and access to and accountability for resources.

Documentation: Management control systems and all transactions and other significant events are to be clearly documented, and the documentation is to be readily available for examination.

1. Internal control objectives and procedures should be formalized in writing.

2. Policies and procedures should be systematically documented, including policies and procedures, manuals or guides, personnel manuals, organization charts, flow charts, or other written descriptions.
3. All transactions and events should be should be adequately documented and documentation should be readily available for examination.
4. Budget justification data should be available and should be consistent with other accounting and budgetary data.

Recording of transactions and events: Transactions and other significant events are to be promptly recorded and properly classified.

Execution of transactions and events: Transactions and other significant events are to be authorized and executed only by persons acting within the scope of their authority.

Separation of duties: Key duties and responsibilities in authorizing, processing, recording, and reviewing transactions should be separated among individuals.

Supervision: Qualified and continuous supervision is to be provided to ensure that management control objectives are achieved.

Access to and accountability for resources: Access to resources and records is to be limited to authorized individuals, and accountability for the custody and use of resources is to be assigned and maintained. Periodic comparison shall be made of the resources with the recorded accountability to determine whether the two agree. The frequency of the comparison shall be a function of the vulnerability of the asset.

Even though management controls may be logical and well-designed and may seemingly be strong, system effectiveness may be impaired if control procedures are not correctly and consistently used. For example, if an entity requires the manager's approval for all purchases over \$25,000 but the manager does not, in fact, review the purchase orders, this requirement will not effectively prevent or detect unnecessary purchases. Thus, the extent that control procedures are adhere to determines the controls effectiveness. Control procedures may not be complied with because management may override them; employees may secretly be working together (collusion) to avoid using or circumvent them; and employees may not be correctly applying them due to fatigue, boredom, inattention, lack of knowledge, or misunderstanding.